



**Department of the Treasury
Internal Revenue Service**

P.O. Box 2508
Cincinnati, OH 45201

Release Number: **201529011**
Release Date: 7/17/2015
UIL Code: 501.07-01
501.07-00

Date:
April 21, 2015
Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

Dear :

This letter is our final determination that you don't qualify for tax-exempt status under Section 501(c)(7) of the Internal Revenue Code (the Code). Recently, we sent you a proposed adverse determination in response to your application. The proposed adverse determination explained the facts, law, and basis for our conclusion, and it gave you 30 days to file a protest. Because we didn't receive a protest within the required 30 days, the proposed determination is now final.

You must file federal income tax returns for the tax years listed at the top of this letter using the required form (also listed at the top of this letter) within 30 days of this letter unless you request an extension of time to file.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection (as required under Section 6110 of the Code) after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in the Notice 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

If you have questions about this letter, you can contact the person listed at the top of this letter. If you have questions about your federal income tax status and responsibilities, call our customer service number at 1-800-829-1040 (TTY 1-800-829-4933 for deaf or hard of hearing) or customer service for businesses at 1-800-829-4933.

Sincerely,

Director, Exempt Organizations

Enclosures:

Notice 437

Redacted Letter 4034, *Proposed Adverse Determination under IRC Section 501(a) Other Than 501(c)(3)*

Redacted Letter 4040, *Final Adverse Determination under IRC Section 501(a) Other Than 501(c)(3) - No Protest*



Department of the Treasury
Internal Revenue Service
P.O. Box 2508
Cincinnati, OH 45201

Date:
April 25, 2015
Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

Legend:

B = date
C = business
D = area
E = individual
F = individual
G = business
x = dollar amount
y = number
z = number

UIL:
501-07-00
501-07-01

Dear :

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code). Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(7) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

Issue(s)

Are you organized and operated for pleasure, recreation, and other non-profit purposes as defined in section 501(c)(7) of the Code? No, for the reasons given below.

Facts

You were incorporated as a mutual benefit corporation with members on B. You are a restaurant that will "provide social interaction through dining, drinking, indoor recreational activities, and musical entertainment among visitors to C, individuals enjoying water activities on D, and the local community as members and guests of members." You provide "food, beverages, and social interactions to the visitors to the campground". Furthermore, you state that "activities will be done at the location of the restaurant (you)". You have only two directors, E and F, who will conduct the activities. Both directors will be paid a "reasonable" salary for managerial duties. E and F share the same last name and address but no relation was documented.

You refer to being "connected" to G. G operates the campground connected to the restaurant. G is a for-profit entity owned in part and managed by E and F. You rent a building and equipment from G,

share office space with G, and have common employees and officers with G. You submitted three contracts – a commercial real estate lease, an equipment rental agreement, and a management agreement. The facility lease describes the property as a restaurant building and use as a private club/restaurant, the equipment agreement states all equipment remains the property of G, and you will cover half of an additional shoreline lease applicable to G, and the management agreement states fees may be billed hourly for the following services: bookkeeping, payroll, quarterly and sales tax filing, maintenance.

All three agreements were between you and G, and all three were signed by E as lessor and F as lessee. The agreements stipulated terms and fees. You submitted no documentation as to how you arrived, negotiated or agreed upon these terms or fees.

Your bylaws state you shall be composed of resident and non-resident members. The board of directors, in its sole discretion, may grant honorary membership. Members must pay an initiation fee and annual dues. Resident members are limited to z and non-resident members are limited to y. Guests are limited to those persons who accompany a member or persons for whom a member has made prior arrangements with management. Your bylaws further stipulate the board of directors shall have the general management and control of the affairs of the club and it's property.

Membership is open to all individuals over 21 years of age. Members are then entitled to purchase food and beverages and/or participate in social activities. Membership fees and dues are x dollars annually. You did not submit a breakdown of resident and non-resident members, however, per total fees and dues submitted you have between 500-700 members. You have stated you will receive no non-member income.

You have not provided nor indicated any regular schedule of events during which members meet, co-mingle, associate or socialize. You have only stated "(you) are for the private benefit use by members and guests". You list one annual meeting at the end of the year, and require only 10 members be present for any meeting to meet quorum.

All of your revenue is listed as food and/or beverage sales, however, you state that you are supported by members who pay a fee to belong entitling them to purchase food and beverages and/or partake in social activities. You later clarified that on your income statements membership fees were actually included in the food and beverage sales. Major expenses include advertising, outside services, payroll, rent and utilities. You also break down cost of goods sold for beer and food purchases, merchant account fees and restaurant supplies. Payments for services include live bands, waitress and cook staff wages.

Law

Section 501(c)(7) of the Code provides for the exemption from federal income tax of clubs organized for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Treasury Regulation 1.501(c)(7)-1 provides as follows:

(a) The exemption provided by section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to

any club if any part of its net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

(b) A club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber, or other products, is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not exempt under section 501(a) [26 USCS § 501(a)]. Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption.

Revenue Ruling 58-588, 1958-2 C.B. 265, held that a social club that sells an unlimited number of memberships to so-called "members", who have no voice in the management of the club and whose only rights are to use the club's facilities upon payment of specified fees, is not a tax-exempt social club within the meaning of section 501(c)(7) of the Code. Income from the members was, in reality, income from the general public.

The organization had two classes of membership, namely active and associate members. The active members controlled all business decisions of the organization and some of the active members were employees of the organization. The ruling held that the organization was operated in the personal interest of a few individuals; that social features are not a material purpose of the club but are subordinate and merely incidental to the active furtherance of a predominant purpose to engage in the business of selling services for profit to an unlimited number of individuals termed "associate members;" that "associate" membership is not a true membership but is merely a guise under which virtually unlimited numbers of individuals may utilize the club facilities; and that income from associate members is in reality income from transactions with the general public

Revenue Ruling 58-589, 1958-2 C.B. 266, sets forth the criteria for determining whether an organization qualifies for tax-exempt status per Internal Revenue Code section 501(c)(7). This revenue ruling clearly states that an organization that makes its social and recreational facilities available for use by the general public is engaged in a business and is not exempt under Internal Revenue Code section 501(a). Further, solicitation by advertisement of public patronage of a social club's facilities will have an adverse effect on its tax exempt status. In addition, this ruling provides that a commingling of the members must play a material part in the life of the organization.

Revenue Ruling 66-225, 1966-2 C.B. 227 held that a nonprofit organization which provides entertainment for its members does not qualify for exemption under IRC 501(c)(7) where it is controlled by a taxable corporation and operated as an integral part of such corporation's business. The club's articles of incorporation state that its purpose is to operate a private club for its members and to provide entertainment, food, and refreshment for them. The clubhouse with all fixtures and equipment is leased by the organization a related motel for a nominal fee, but the motel retains the exclusive right to serve food and other beverages to the club's members. The club has no net worth. Its income is received from membership dues and fees, about one-fourth of which is realized from temporary members. Practically all of the organization's income is spent for entertainment.

Revenue Ruling 69-635, 1969-2, C.B. 126, held that an organization was not exempt under section 501(c)(7) of the Internal Revenue Code because the organization was designed to provide services to its members and there was no significant commingling of members.

Application of law

An organization cannot be recognized as exempt under section 501(c)(7) unless it shows that it is both organized and operated substantially for pleasure, recreation or other nonprofit purposes. You are formed primarily to operate a restaurant. You offer a nominal membership fee allowing anyone who pays the opportunity to dine at your restaurant and purchase food/drink. This primarily includes visitors to a campground and their guests. Regulation 1.501(c)(7)-1(b) provides that a club which engages in business is not organized and operated exclusively for pleasure, recreation, and other nonproftable purposes, and is not exempt. One evident fact is solicitation by advertisement. One of your larger expenses is advertisement and promotion which is questionable for an entity describing itself as a private club. You have stated your activities are to provide food, beverages, and social interactions to the visitors of the campground, and D. For these reasons you do not meet the operational test under 501(c)(7).

Treasury Regulation 1.501(c)(7)-1(a) states exemption provided by section 501(c)(7) does not apply to any club if any part of its net earnings inure to the benefit of any private shareholder. Your restaurant is run by your only two board members (E and F), has contracts with a for-profit company partially owned by E and F and pays fees to those same individuals through not only those contracts but also for management services. Funds generated from the club (restaurant) are flowing directly to E and F through these arrangements resulting in inurement disqualifying you from exemption under 501(c)(7).

You are similar to the organization described in Revenue Ruling 58-588. Although you have capped the total number of members you may have, these far exceed the amount of people that could be present in your restaurant at any one time. Further, the membership fee itself is nominal and there are few barriers to membership outside of paying the fee. You are also similar in that you have two classes of members and that you are operated for the personal interest of a few individuals – here, E and F. While you have stated your activities are to provide social interaction this can only occur for those members present in the restaurant at that time; you have no other planned social functions – your social features are not a material purpose of your club but are subordinate and incidental to the purpose of engaging in a business of selling services for profit to members, here, selling food and drinks at a restaurant. Additionally, membership is not a true membership but is merely a guise under which virtually unlimited numbers of individuals may utilize your facilities. Your board, consisting of E and F, has the general management and control of the affairs of the club and its property. Realistically, only a fraction of your members could actively participate in your social activities. The only rights accorded members are the rights to purchase food in the dining room and to participate in the few social activities you conduct. Any income generated therefrom is in reality income from transactions with the general public.

You are similar to the organization described in Revenue Ruling 66-225. You have a three part agreement in place with G, a for-profit entity owned by E and F, in which you lease not only the restaurant facility but also equipment and services – which include routine daily business functions of the restaurant and staff. You also share office space, employees and officers with G. You are controlled by and operated as an integral part of a for-profit entity, G.

Similar to Revenue Rulings 58-589 and 69-635, you do not qualify under 501(c)(7) as you have no evidence of regular commingling of members. Commingling is a material part in the life of a section 501(c)(7) social club, and is present if such things as meetings, gatherings and regular facilities are present. Lack of commingling indicates a basic purpose of providing personal services and goods to the membership in a manner similar to commercial counterparts. You operate a restaurant/bar that is effectively open to the general public for a de-minimus fee. Your membership primarily consists of individuals who happen to visit the campground or lake and pay your fee. You provided no evidence of regular membership meetings and gatherings and E and F are running the daily operations of the club through their for-profit entity, G.

Conclusion

You are not organized and operated for pleasure, recreation, and other non-profitable purposes as defined in section 501(c)(7) of the Code. Further, your activities are structured to allow your earnings to inure to insiders. For these reasons you do not qualify under 501(c)(7).

If you don't agree

You have a right to file a protest if you don't agree with our proposed adverse determination. To do so, you must send a statement to us within 30 days of the date of this letter. The statement must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A copy of this letter highlighting the findings you disagree with
- An explanation of why you disagree, including any supporting documents
- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative
- One of the following declarations:

For an officer, director, trustee, or other official who is authorized to sign for the organization:

Under penalties of perjury, I declare that I examined this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

For authorized representatives:

Under penalties of perjury, I declare that I prepared this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, *Power of Attorney and Declaration of Representative*, with us if he or she hasn't already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*.

We'll review your protest statement and decide if you provided a basis for us to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't provided a basis for reconsideration, we'll forward your case to the Office of Appeals and notify you. You can find more information about the role of the Appeals Office in Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*.

Where to send your protest

Please send your protest statement, Form 2848, if needed, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You can also fax your statement and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that he or she received it.

If you agree

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

You can find all forms and publications mentioned in this letter on our website at www.irs.gov/formspubs. If you have questions, you can contact the person listed at the top of this letter.

Sincerely,

Enclosure
Publication 892

Director, Exempt Organizations